April 6, 2009

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on 1/28/09 Advanced Notice of Public Rulemaking (ANPR) for Part 704

Dear Ms. Rupp:

I appreciate the opportunity to comment to NCUA on this ANPR. Certainly, the future of the corporate credit union network is certainly on the forefront of the minds of many of us in the movement, including those in the Agency. As such, it is imperative that we plan for that future in the context of the environment that is expected to exist.

Unfortunately, the general approach being considered within this ANPR does not do so. Instead, it is essentially limited to addressing only those conditions that caused the current financial issues being faced by our corporate credit unions. That type of back-looking approach will likely not result in the type of meaningful systemic changes the Agency is seeking. Instead, at best, it will only serve to possibly ensure that the corporates will be better positioned to weather a repeat of the current conditions at some point in the future. That clearly does little to help position the corporate network to address the opportunities and challenges of the future, and therefore falls short of meaningful reform.

With respect to the specific *Issues for Consideration* cited in the ANPR, I would like to offer the following thoughts:

1. **The Role of Corporates in the Credit Union System –** In general, there is still a great need for corporates within the credit union system. They continue to provide important services to credit unions in the areas of investments, payment services, education and other functions. They offer expertise and economies of scale in areas that most individual credit unions are still not able to provide today. While it is true that a relative handful of credit unions nationally have grown to a size and level of sophistication where they no longer have a use for the services provided by the corporates, those institutions represent only a tiny percentage of all credit unions. Even if we accept the projections that the number of credit unions in the U.S. will reduce to 5,000 within the next 10 years, there will still be a need for corporate credit unions for nearly all of those that remain.

   <u>Disagreements</u> - The idea of single function charters for corporates is simply an unsound business theory. Certainly the desire to see that certain business activities are insulated from

disruptions in other areas has credibility. However, limiting any enterprise to a single line of business would only ensure one future certainty…failure. Economic theory has demonstrated time and again that no business line is immune from cyclical swings. Even though one may not be able to envision a scenario where a certain line of business would become economically challenged, that does not mean that such scenarios do not exist. That is why the concept of diversification has become accepted as an important practice. The Agency has historically recognized this fact in its interactions with natural person credit unions, as there are multiple statutory and regulatory prohibitions against becoming overly concentrated in a single activity.

The issue of building appropriate scale in such a single service corporate is also one that would be a challenge to overcome. This would likely lead to difficulties in capitalizing such institutions, as there would likely not be much possibility for an appropriate return on such an investment.

The concept of limiting corporate fields of membership based on geography is equally problematic. Doing so would not limit risk, but would instead exacerbate it by increasing geographic concentrations. Such artificially imposed barriers to conducting business no longer represent appropriate business methodologies in an economy that is becoming increasingly global.

Eliminating expanded investment authorities would represent an overreaction to the current situation as well. Although I possess nothing more than an anecdotal understanding of those authorities, I do know that they have been utilized to increase the earnings of our corporates in the time that they have had them. I also know that natural person credit unions, which do not possess such expanded authorities, became understandably concerned about the credit quality of some of their GSE and banking investments when the issues in those sectors came to light last year. Therefore, the Agency should explore ways to utilize smarter regulation over the expanded investment authorities granted to corporates, not do away with them.

Agreements - The concept of establishing "distinct capital requirements for payment systems risk and the risks of the other corporate services"[1] is absolutely something that should be fully explored and implemented. It could be utilized to help the Agency more effectively regulate all of the concerns addressed above.

In fact, this idea of risk based capital should be extended well beyond corporate credit unions and into the natural person credit union realm as well. This is something the Agency has officially recognized for the past several years, and is also an idea that has been supported by the industry. Therefore, the time has come for NCUA to take the lead on this issue on Capitol Hill and within the Administration to finally bring this concept into fruition.

No Opinion – With respect to the need for a multi-tiered corporate system, I do not have an adequate understanding of the pros and cons of such a system to offer an informed opinion.

[1] 7535-01-U, National Credit Union Administration, RIN 3133-AD58, ANPR, page 7

2. **Corporate Capital –** With respect to the need to make changes to the system of evaluating the capital in the corporate system, I feel once again unqualified to offer any definitive solutions, as it is unclear from the ANPR how the current methodology is perceived to increase the risk to the system.

   Disagreements - With that said, a goal of making corporate capital requirements more consistent with standards utilized by other federal financial regulators does not seem to make much sense, as those standards do not seem to have done much to protect the banking sector from the incredible turmoil it is currently facing. If capital standards are truly an issue for the corporate credit unions and considered one of the causes for their current state, then logic would dictate that they also be considered an equal issue within the banking world. From that perspective, marrying the two systems would seem to accomplish little.

   The issues we are confronted with today are related to asset quality and really seem to have little to do with standards for capital. Nor do they have anything to do with:

   - Contributed capital levels from natural person credit unions,
   - Corporates providing services to natural person credit unions that are not shareholders or
   - The size of an individual credit union's corporate capital contribution as it relates to their share balances or asset size.

   Since it is unclear that any of these issues has increased risk within the corporate system, they should be treated as corporate governance matters that should not be controlled by regulation.

   Agreements - This section of the ANPR once again poses the issue of risk-based capital for corporates. While not being in favor of a system that seeks to match what other federal regulators are doing simply for the sake of consistency, I remain strongly supportive of implementing such a risk-based capital system that is appropriate for our corporate system. Furthermore, that concept should also be extended to natural person credit unions.

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3. **Permissible Investments –** Having previously commented on the expanded investment authorities granted to corporates, this response will be limited to the contemplated prohibitions of certain investment categories. Any consideration of such prohibitions must neither be overly broad, nor based solely on the fact that such instruments did not function well in the current economic environment that is, by many accounts, unprecedented. Regulation crafted from such a mindset inevitably proves needlessly restrictive and overly burdensome. In addition, it also fails to provide any semblance of a forward looking approach to dealing with future issues. Simply seeking to prevent investments in instruments that have at one time or another experienced losses of principal would restrict the universe of permissible investments to little more than U.S. Treasuries. In fact, this type of thinking could ultimately be used to prevent natural person credit unions from even investing in the NCUSIF.

4. **Credit Risk Management –** Clearly this needs to be a key area of concern for both the Agency and the industry. However, once again, the desire to return everything to a "quieter and simpler time" is simply not reflective of the increasing complexities of the economic world in which all credit unions, corporate and otherwise, must conduct their business today.

   Disagreements - The ANPR touches on one of the key issues with respect to this risk area, which is the absence of appropriate regulatory oversight of rating organizations. However, instead of using this as a reason for curbing the ability of corporates to rely on NRSROs, wouldn't it be more appropriate for NCUA to actively engage in bringing about the changes necessary to increase their oversight to an appropriate level? This approach would appear to present several opportunities:

   1. It would help increase the accountability of the NRSROs, and therefore result in better tools for not only corporates, but also natural person credit unions that rely upon their ratings.
   2. It would offer the opportunity for NCUA to take a lead role in a high profile area that would bring about meaningful change on behalf of not only the institutions it regulates, but the investing public at large. Not only would the Agency benefit from such an increased profile, but so to would the credit union industry as a whole.

   Also, given that the Agency now considers the reliability of the ratings from the NRSROs to be suspect, it would seem to make no sense to require:

   - More than one rating for an investment or
   - That the lowest rating meets the minimum rating requirements of Part 704.

   There should be no perceived strength in the number of ratings if the whole ratings system is considered seriously flawed. Likewise, such flaws should also preclude the use of the lowest rating, given that there is no evidence that those NRSROs that provide lower ratings do a better job of credit risk assessment than those that give higher ones.

   The use of additional stress modeling tools would not have prevented the current corporate situation. It was not about the number of tools being used. Instead, the reality we are facing today was never contemplated in the various models that were utilized. Even if NCUA had engaged an entity like PIMCO back in 2006 or 2007, the projections they would have likely provided regarding the holdings of the corporates would have been far rosier than those the Agency recently received. That's simply because few, if any, forecasted the depth and severity of the economic climate we are now experiencing.

   Agreements – The concept of requiring for independent risk evaluations of portfolios does seem to have merit. However, if the oversight of those entities, like PIMCO, is no better than that which exists for the NRSROs, then their work product must be considered equally suspect.

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5. **Asset Liability Management** – I have no comment on this section except to express the continued concern that reinstituting tools that have only proven useful during an unprecedented market dislocation that was never forecast would seem to require an inefficient use of resources both within the corporate credit union system and the regulatory agency.

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6. **Corporate Governance** – It seems more than a little disingenuous for NCUA to use this ANPR as an opportunity to cast aspersions on those volunteers that serve on the Boards of Directors of the corporates. To essentially label those individuals as being lacking in the acumen and wherewithal to serve in such a capacity is unconscionable. It also represents a slap in the face at all of the other volunteers that are the backbone of the entire credit union system.

   To also imply that one or more paid directors from outside of the industry would have had far greater insight to foresee these events is equally ludicrous. That would only be true if the corporate credit union system was the only part of the financial world that did not anticipate such occurrences, which is obviously not the case. Paid, independent directors have long existed in the for-profit banking world, the automobile industry, construction companies and all other sectors that are struggling to deal with this current situation.

   Those who serve as Directors are rightfully accountable for the performance of the entities they oversee. As such, they have a responsibility to be educated in matters pertaining to those enterprises, both internally and externally. They are clearly more motivated to do so when they have a vested (i.e. ownership) interest in those entities. And yet, even in spite of their best efforts, sometimes those companies have financial difficulties, including even failure. This does not mean that the Directors were necessarily flawed as individuals; it only means that they did not make appropriate decisions.

In conclusion, it is interesting that there is one factor that is not mentioned within the ANPR as a potential candidate for change as a result of issues within corporate credit unions. That is consideration for changes within the National Credit Union Administration itself. For years, NCUA has had full time examiners based within the two corporates that have now been placed under conservatorship. Therefore, those institutions have consistently been under the watchful eyes of the agency, which seemed appropriate given the level of complexity within those entities. Therefore, one logical question would be that if the need has existed to address these issues that are now being identified as systemic within the corporate credit union network, why have they not surfaced from the Agency before now when those examiners were literally witnessing all of the activity now being questioned? Furthermore, why was it appropriate for some within the Agency to whom these corporate examiners ultimately reported to receive promotions at a time when the Boards and upper management within the corporates were deemed ultimately accountable for the issues that have arisen? Does this not also point out the need for change related to the organization, structure and regulation over the corporate system?

My purpose in raising these questions is not to be accusatory or disrespectful. Instead, it is to point out once again that the situation we are now dealing with is something nobody anticipated or saw coming.

That includes economists, credit union professionals at both the corporate and natural person levels, politicians and regulators. Therefore, the credit union industry and our regulators must work to ensure that we are not overly reactive in addressing the fallout from it. While it is certainly important to learn from this situation in an attempt to help mitigate future impacts from similar circumstance in the future, we should also be mindful that if we go too far by proverbially "throwing the baby out with the bath water", we will risk permanently damaging the credit union franchise for the future.

Thank you again for your time and attention.

Sincerely,

Wally Murray
President/CEO